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Supreme Court of the United States

OCTOBER TERM 1940

No. 734

MARY FLAGLER CARY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 735

HARRY HARKNESS FLAGLER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 736

ESTATE OF ANNIE L. FLAGLER, DECEASED,
HARRY HARKNESS FLAGLER, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 737

JEAN LOUISE MATTHEWS,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR THE PETITIONERS

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INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	2
THE ISSUE INVOLVED	2
STATUTES INVOLVED	2
STATEMENT OF FACTS	3
SPECIFICATION OF ERRORS	11
OUTLINE OF ARGUMENT	11
ARGUMENT	14
I—At the time of the enactment of the Revenue Act of 1934 the phrase "time of acquisition" as used in Section 113(a)(5) had been defined by long-continued departmental interpretation, judicial decisions and legislative history to mean that legatees did not acquire property until a substantial interest therein became vested in them	14
A. Departmental Interpretation	16
B. Judicial Interpretation	17
C. Legislative History	21
D. Cases under the Revenue Acts of 1928 and 1932 do not resolve the questions in the instant cases	28

PAGE

E. In any event, Regulation 86, promulgated February 11, 1935, cannot affect retroactively tax liability for 1934 31

II—The Petitioners herein did not acquire the property sold in 1934 and 1936 prior to the termination of the trust created under the will of Henry M. Flagler 32

A. Under Florida law Petitioners took only contingent interests under the will 36

1. Petitioners in Nos. 734 and 737 37

2. Petitioners in Nos. 735 and 736 41

B. Petitioners had no substantial ownership of the property until the termination of the trust. 50

CONCLUSION 52

APPENDIX i

Statutes i

Regulations iii

Committee Reports v

1928 Act v

Basis for Gain or Loss on Sales by an Executor v

Sec. 113.—Basis for Determining Gain or Loss —Executors' Sale vi

1934 Act viii

TABLE OF CASES CITED

PAGE

Anchor Realty & Investment Co. v. *Becker*, 3 F. Supp. 22 (E. D. Mo. 1933), aff'd., 71 F. (2d) 355..... 20

Beers v. *Commissioner*, 78 F. (2d) 447 (C. C. A. 3d, 1935) 20

Blocker v. *Blocker*, 103 Fla. 285 (1931).....40, 51n

Booth v. *Baptist Church*, 126 N. Y. 215 (1891)..... 48n

Brewster v. *Gage*, 280 U. S. 327 (1930), 11, 12, 16, 17, 18, 19, 27n

Chandler v. *Field*, 63 F. (2d) 13 (C. C. A. 1st, 1933) 21

Commissioner v. *Kellog*, 1941 P-H Fed. Tax Serv. § 62,547 (C. C. A. 3d, 1941)..... 36n

Corliss v. *Bowers*, 281 U. S. 376 (1930)..... 34

Dean v. *Crews*, 77 Fla. 319 (1919).....36, 40

Forbes v. *Commissioner*, 82 F. (2d) 204 (C. C. A. 1st, 1936) 48n

Gredig v. *Sterling*, 47 F. (2d) 832 (C. C. A. 5th, 1931) 47n

Helvering v. *Campbell*, — U. S. — (1941).....13, 28, 29

Helvering v. *Dunning*, 1941 P-H Fed. Tax Serv. § 62,522 (C. C. A. 4th, 1941)..... 15

Helvering v. *Gambrill*, — U. S. — (1941).....13, 28, 29

Helvering v. *Hallock*, 309 U. S. 106 (1940)..11, 15, 29, 35

Helvering v. *Janney*, 311 U. S. 189 (1940)..... 16

Helvering v. *Oregon Mutual Life Insurance Company*, 311 U. S. 267 (1940)..... 16

Helvering v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1938) 31

Helvering v. *San Joaquin Co.*, 297 U. S. 496 (1936), 13, 21, 32

Hopkins v. *Commissioner*, 69 F. (2d) 11 (C. C. A. 7th, 1934) 20, 21

PAGE

In re Harrington's Will, 243 App. Div. 235 (4th Dept., 1935) 47n
In re Walter's Estate, 150 Misc. 512 (N. Y. Co. 1934) 47n

Lane v. *Corwin*, 63 F. (2d) 767 (C. C. A. 2d, 1933).. 20

Maguire v. *Commissioner*, — U. S. — (1941), 13, 21, 27n, 28, 29, 31
McKinney v. *United States*, 62 Ct. Cl. 180, cert. den., 273 U. S. 716 (1926)..... 22
Molter v. *Commissioner*, 69 F. (2d) 7 (C. C. A. 7th, 1934) 20, 21

National Surety Co. v. *McGreevy*, 64 F. (2d) 899 (C. C. A. 8th, 1933)..... 33

Paul v. *Frierson*, 21 Fla. 529 (1885).....38, 39
Pringle v. *Commissioner*, 64 F. (2d) 863 (C. C. A. 9th, 1933) 18, 20

Rewis v. *Rewis*, 79 Fla. 126 (1920)..... 39
Reynolds v. *Commissioner*, 114 F. (2d) 804 (C. C. A. 4th, 1940) 21
Roebling v. *Commissioner*, 78 F. (2d) 444 (C. C. A. 3d, 1935) 20
Rowland v. *Miller*, 81 Fla. 408 (1921).....37n, 45

Salomon v. *State Tax Commission of New York*, 278 U. S. 484 (1929)..... 51n
Sorrels v. *McNally*, 89 Fla. 457 (1925).....37n, 47

Taft v. *Helvering*, 311 U. S. 195 (1940)..... 16
The Standard Oil Company of New Jersey v. *The United States*, 221 U. S. 1..... 3

Uterhart v. *United States*, 240 U. S. 598 (1916).... 36

Van Vranken v. *Helvering*, 115 F. (2d) 709 (C. C. A. 2nd, 1940).....14, 21

Warner v. *Commissioner*, 72 F. (2d) 225 (C. C. A. 2d, 1934) 20

STATUTES AND AUTHORITIES CITED

PAGE

Judicial Code:

§ 240(a) 2

Internal Revenue Code:

§ 1141(a) 2

Revenue Acts:

§ 113(a)(5) of the Revenue Acts of 1934 and 1936, 2, 10, 11, 13, 20, 21, 23, 30, 51
§ 204(a)(5) of the Revenue Acts of 1924 and 1926 20
§ 202 of the Revenue Act of 1918..... 22
§ 113(a)(5) of the Revenue Act of 1932.....24, 25
§ 113(a)(5) of the Revenue Act of 1928.....27, 29, 30

Article XIII, Regulations 80 (as amended by T. D. 5,042, March 1, 1941).....15n, 35

Bureau of Internal Revenue:

O. D. 727, 3 C. B. 53 (1920)..... 16
G. C. M. 10,260, XI-1 C. B. 79 (1932).....17, 33
G. C. M. 11,309, XII-1 C. B. 126 (1933)..... 17
G. C. M. 6,195, VIII-1 C. B. 99 (1929)..... 17

Senate Report No. 960, 70th Congress, 1st Session.. 24

1 Simes, Law of Future Interests § 67 (1936).....36, 38

Thompson, Wills § 361 (2d Ed. 1936)..... 37

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BRIEF FOR THE PETITIONERS

All references to the Record in these cases will be to the Record in the case of *Mary Flagler Cary* v. *Commissioner,* No. 734, unless otherwise specified.

OPINIONS BELOW

The opinions of the Board of Tax Appeals (No. 734, R. 75; No. 735 R. 27; No. 736, R. 25; No. 737, R. 25) are unreported.

The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit, 116 F. (2d) 800, was rendered January 17, 1941, and appears at R. 93.

JURISDICTION

The jurisdiction of this Court is invoked under § 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. 347(a)), and § 1141(a) of the Internal Revenue Code. The decrees of the Circuit Court of Appeals for the Second Circuit were entered on January 22, 1941 (No. 734, R. 94; No. 735, R. 48; No. 736, R. 46; No. 737, R. 45). A consolidated petition for certiorari was filed January 30, 1941, and was granted March 10, 1941 (No. 734, R. 95; No. 735, R. 49; No. 736, R. 47; No. 737, R. 46).

THE ISSUE INVOLVED

These cases involve the meaning of the phrase "fair market value of property at the time of acquisition" in a situation where legatees first acquired substantial ownership of such property upon the termination of a trust ten years after the death of the testator. The cases arose under § 113(a)(5) of the Revenue Acts of 1934 and 1936.

STATUTES INVOLVED

The statute directly involved in these cases is § 113(a)(5) of the Revenue Acts of 1934 and 1936, which is the same in both Acts. It reads as follows:

> "If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the

decedent, the basis shall be the fair market value of such property at the time of such acquisition."

Provisions of earlier Acts and Bills which are material in establishing the proper construction of this section are set out in the Brief where relevant and are gathered together in the Appendix.

STATEMENT OF FACTS

The facts in these cases were stipulated (No. 734, R. 17-74; No. 735, R. 21-26; No. 736, R. 19-23; No. 737, R. 20-24), and the Board of Tax Appeals found the facts as stipulated (No. 734, R. 75; No. 735, R. 27; No. 736, R. 25; No. 737, R. 25). The facts may be summarized as follows:

During 1934 and 1936 the Petitioners sold various shares of stock of Standard Oil Export Corporation. In order to state clearly the facts in these cases it is necessary first to trace the history and origin of that stock.

In *The Standard Oil Company of New Jersey* v. *The United States,* 221 U. S. 1, this Court affirmed with modifications a decree providing for the disintegration of Standard Oil Company of New Jersey. In about the year 1911 the stockholders of Standard Oil Company of New Jersey received in connection with the disintegration of that company, among other things, one ordinary share of the stock of Anglo-American Oil Company, Limited, for each share held of the stock of Standard Oil Company of New Jersey (R. 19). Between 1913 and 1925 Anglo-American Oil Company, Limited, issued various stock dividends and rights (R. 20) with the result that one share of Standard

Oil Company of New Jersey held in 1911 was by the end of 1925 represented in part by four shares of Anglo-American Oil Company, Limited. In 1930 the shares of Anglo-American Oil Company, Limited, were exchanged in a tax-free reorganization for preferred stock of Standard Oil Export Corporation (R. 20) which is the stock the sale of which gave rise to the income involved in these cases.

The parties and the Court and Board below have not attached any tax significance to the corporate changes traced in the preceding paragraph. A knowledge of the changes is necessary, however, because the Petitioners who in 1934 and 1936 sold the Standard Oil Export stock had received[1] in 1923[2] stock of Anglo-American Oil Company, Limited, from testamentary trustees under the will of Henry M. Flagler dated February 1, 1902 which speaks in terms of stock of Standard Oil Company of New Jersey.

Said Henry M. Flagler (hereinafter called the Testator) had died on May 20, 1913, a resident of the State of Florida (R. 18), leaving a last will and testament dated February 1, 1902, and seven codicils dated from February 17, 1903, to September 13, 1912. Substantially all the Testator's property, including the stock of Anglo-American Oil Company, Limited, referred to above, had been

---

[1]Except Annie L. Flagler, whose estate is the Petitioner in No. 736. She received the stock involved in this case as a gift from her husband, Petitioner in No. 735, in 1932 (No. 736, R. 22). Harry Harkness Flagler, however, received this stock as indicated above and therefore the situation is the same as to both of these parties.

[2]Except, in so far as property in these cases is involved, as to 10,000 shares of the stock of Anglo-American Oil Company, Limited, distributed to Harry Harkness Flagler, Petitioner in No. 735, on April 26, 1921 (No. 735, R. 24). See also Note 1, above.

left by him under his will to trustees for the purpose stated in Item Third of his will, as follows:

> "THIRD: I have been for many years investing in railroads, hotel and land companies in the state of Florida, and it is my intention in the future to foster, protect and properly develop such properties, and to provide against my decease while such properties are in the processes of development and to relieve my beloved wife, hereinafter named, from the immediate cares and responsibilities of so varied and such extensive interests, I hereby declare a trust concerning all my property, both real and personal, and wheresoever situated * * *." (R. 23.)

The trust was to continue for a term of five years from the time of the death of the Testator, and for an additional term not exceeding five years if the Testator's Florida properties should be in such condition as "to require financial aid from sources outside of themselves * * *." (R. 25.) Thus, Item Fifth of said last will and testament provided as follows:

> "FIFTH: The balance of my estate I place, according to the purpose declared in the 'Third' Item of this instrument, in the hands of my said Trustees, to be used, managed and controlled by them and their successors for the purpose of protecting, fostering, operating and developing during the life of such trust, all my Florida properties according to the purposes indicated by the charters of the several companies, and as nearly along the lines which I have adopted, or may hereafter adopt, as may be consistent with their judgment, and discretion under the conditions which may hereafter exist. The said trust shall continue for five years from the time of

> my death, and if at the end of such five years the condition of the Florida East Coast Railway Company and the Florida East Coast Hotel Company (they being my Florida railroad and hotel properties referred to) or of either of them should be such as to require financial aid from sources outside of themselves or itself, then I direct that such trust shall continue so long as either or both of such last named companies shall require such assistance, but not longer, however, than a period of five years from the termination of the above mentioned or first period of five years. * * *" (R. 24, 25.)

The trust did, in fact, continue for a period of ten years from the time of the death of the Testator and terminated on May 20, 1923 (R. 19).

The Testator provided in Item Sixth of his said last will and testament that from and after his death the annual sum of $100,000 should be paid his wife, Mary Lily Flagler, and the trustees were directed to pay to said Mary Lily Flagler, in addition, so much of the annual net income from the trust property as should not be required for trust purposes during any extended period of the trust beyond the original five years (R. 25).

The trustees of the trust created by the Testator's last will and testament were given broad powers over the trust property. Item Tenth of said last will and testament provided in part as follows:

> "TENTH: For the purpose of the fulfillment and due execution of the above trust I hereby invest my Trustees with full power and authority to execute all such instruments, obligations, assignments or transfers as may be necessary in the course of their business as such Trustees and to renew, refund, and

by new obligation to provide for the extension, adjustment and payment of any and all obligations that I may leave outstanding at the time of my decease, to the end that if possible all and any such obligations shall be paid and discharged out of the income of my estate during the continuance of such trust.

* * * * * *

"It is my will and intention, in so far as I am legally able to do so to exempt my Trustees in the matter of investment and reinvestment of any portion of my estate from the limitations as to the classes of securities that may be named in the provisions of the statutes of the state of Florida or of any other state or of the United States in respect to the investment of the proceeds and income of trust estate; the principal object of this exemption being that if any of the various enterprises, companies or corporations referred to above in which I am interested shall require temporary assistance the provisions of such statutes shall not interfere to prevent any loan to or on account of such companies or corporations as in the absence of such statutory restrictions might seem wise or advisable on the part of my said Trustees; it is, however, not my intention that any such assistance shall be extended to any other than the following companies:

"The Florida East Coast Railway Company, and the Florida East Coast Hotel Company." (R. 28, 29.)

The Testator made his wife, Mary Lily Flagler, the residuary legatee of his estate. Thus it was provided in Item Ninth of said last will and testament as follows:

"NINTH: All the rest, residue, and remainder of my estate whether real or personal and whereso-

> ever situate, including of course all property covered by or included in said trust and not payable out of the same or at the end of said trust and all other property and estate of any and every kind whatsoever, I give, devise and bequeath to my beloved wife, Mary Lily Flagler (formerly Mary Lily Kenan of Wilmington, North Carolina) forever, and I hereby authorize, empower, and direct my said executors and Trustees to pay over and transfer to my said wife at the expiration of said trust all such estate and property. And it is my intention to include in this gift, bequest and devise all accumulations or enlargements of my estate and property as shall have arisen during the life and operation of said trust; and it is also my intention to include in such devise my summer home at Mamaroneck, in the County of Westchester, state of New York, and my property, Number Twenty-one West Fifty-fifth Street in the city of New York, state and county of New York." (R. 28.)

The Testator also provided by Item Fifth of the codicil of April 28, 1904, that nine individuals named therein or their heirs should constitute his residuary legatees in case his wife, Mary Lily Flagler, should predecease him and he should leave no children surviving him except his son Harry Harkness Flagler (R. 36).

Item Seventh of said last will and testament provided in part as follows:

> "SEVENTH: At the expiration of said trust, the Trustees shall deliver, assign, and transfer by proper instrument or instruments to my son Harry Harkness Flagler, Five Thousand (5,000) shares of the capital stock of the Standard Oil Company of New Jersey, which shares of stock are hereby given to

> my said son. And in the event that at the expiration of said trust there shall be any child or children of my said son living, then I direct that eight thousand shares of the stock of the said Standard Oil Company shall be delivered, assigned and transferred to such child or children as shall then be living, such children, if there be more than one child, to take such stock in equal proportions, and should there be no child of my said son living at the termination of said trust, then such eight thousand shares of stock shall remain a part of such trust estate and go to my wife with the balance of the residue thereof the same as if no provision had been made herein as to such eight thousand shares of stock. * * *" (R. 25, 26.)

Harry Harkness Flagler, Petitioner in No. 735, was the only son of the Testator (No. 735, R. 22). Petitioners in Nos. 734 and 737 are two of the three children of Harry Harkness Flagler (No. 734, R. 19; No. 737, R. 21). Annie L. Flagler was the wife of Harry Harkness Flagler (No. 736, R. 22).

By Item Second of the codicil of April 28, 1904, it was provided as follows:

> "SECOND: I wish further to say, in explanation of the provision made in Item numbered 'Seventh' of my said last will and testament for my son Harry Harkness Flagler, that in case he should not be living at the time of my death or at the time of the expiration of the trust therein referred to, such expression 'expiration of said trust' to be understood as explained in the Item numbered 'First' of this codicil, then the legacy of shares of capital stock of the Standard Oil Company therein mentioned shall lapse and become a part of the residue of my estate." (R. 34, 35.)

By Item First of the codicil of September 13, 1912, it was provided in part as follows:

> "* * * I do hereby declare it to have been, and still to be my intention to include by the term of shares of Standard Oil stocks, in my said last will and testament, the said shares, or such other shares of stock, property and rights as have been, or may hereafter be issued to or received in the place and stead of said shares of Standard Oil stocks as the same existed at the time of the making of my last will and testament, excepting therefrom, however, such subscription rights under said stock or arising from the ownership thereof, as I have heretofore or may hereafter exercise and pay for." (R. 45.)

By Item Second of the codicil of September 13, 1912, it was provided as follows:

> "Second. It is my will that the legacy and bequest to my son, be void and lapse, if my said son should die before me, and in that event, the legacy and bequest, to him, shall become and be part of my residuary estate." (R. 45.)

Upon the termination of the trust the trustees delivered, assigned, and transferred to the Petitioners the appropriate amounts of stock of Anglo-American Oil Company, Limited, which, as explained above, were represented in 1934 and 1936 by the stock then sold by the Petitioners.

Purporting to apply § 113(a)(5) of the Revenue Acts of 1934 and 1936 and disregarding the intervening trust in which had been vested complete dominion over the property in question and over the income therefrom the Board determined that the property in question had been "acquired" by the Petitioners upon the death of the Testator

in 1913 and accordingly entered its orders to the effect that the tax basis of the Anglo-American stock in the hands of the Petitioners was its fair market value on May 20, 1913, adjusted for intervening changes. The Circuit Court of Appeals for the Second Circuit affirmed the orders of the Board (No. 734, R. 94; No. 735, R. 48; No. 736, R. 46; No. 737, R. 45). The present proceedings are brought to review the orders of the Circuit Court of Appeals for the Second Circuit.

SPECIFICATION OF ERRORS

Petitioners urge that the Circuit Court of Appeals for the Second Circuit erred:

(1) in holding that these cases were ruled by the decision of this Court in the case of *Helvering* v. *Hallock,* 309 U. S. 106 (1940); and

(2) in affirming the orders of the Board and in failing to reverse and set aside such orders.

OUTLINE OF ARGUMENT

Whatever may be present views as to a desirable interpretation of the language used by Congress in § 113(a)(5), there cannot be any doubt whatever that on May 10, 1934, when the Revenue Act of 1934 was enacted, the accepted interpretation was that legatees did not acquire property until a substantial interest therein became vested. That interpretation may or may not have been based upon a misunderstanding of the decision in *Brewster* v. *Gage,* 280 U. S. 327 (1930). The controlling fact is that at that

time *Brewster* v. *Gage* was not understood to apply to legatees who did not have a substantial interest in the property involved. At that time "acquisition of property" meant acquisition of the property which was sold and which gave rise to the gain sought to be taxed and did not mean the acquisition of a tenuous right to acquire some property in the future.

1. From at least 1920 the Bureau of Internal Revenue had consistently held that "one who has a mere contingent interest does not 'acquire' the property in question until his interest becomes vested". G. C. M. 10260, XI-1 C. B. 79, 80. That Memorandum of the General Counsel for the Bureau of Internal Revenue distinguished *Brewster* v. *Gage*.

2. Various Circuit Courts of Appeals had consistently held or stated the same rule. They distinguished *Brewster* v. *Gage*.

3. The Reports of Congressional Committees and the legislative history of § 113(a)(5) show that Congress intended to abolish the difference of treatment of legacies of real and personal property but did not intend to depart from the well-settled construction of the language of § 113(a)(5). In 192[illegible] Congress had deliberately rejected a provision which would have been consistent with the more recently discovered so-called "value-at-death principle." That "principle" was a concept first enunciated in Regulations 86 published February 11, 1935, in the year following some of the transactions involved in these cases.

In brief, every applicable test for determining the intention of Congress in reenacting in § 113(a)(5) of the Revenue Act of 1934 language which had appeared in the Revenue Acts of 1926 and prior years shows that Congress was not departing from the well-settled and obvious construction of that language.

This Court in *Helvering* v. *San Joaquin Co.*, 297 U. S. 496 (1936), clearly drew the distinction between the acquisition of property and the acquisition of an interest therein.

The cases of *Maguire* v. *Commissioner*, *Helvering* v. *Gambrill* and *Helvering* v. *Campbell* involved the Revenue Acts of 1928 and 1932 wherein Congress departed from the language used in the Revenue Acts of 1934, 1926 and prior years. The language of the 1928 Act did not have any background of departmental or judicial interpretation. Those cases cannot, therefore, be decisive of the interpretation of § 113(a)(5) of the Revenue Acts of 1934 and 1936 involved in the instant cases the provisions of which had had a long history of departmental and judicial interpretation.

The instant cases involve provisions of law and considerations not involved in the *Maguire* and companion cases, and involve in part transactions which took place in the year 1934 prior to the promulgation on February 11, 1935, of Regulations 86 which first prescribe the rule now sought to be applied.

ARGUMENT

I

AT THE TIME OF THE ENACTMENT OF THE REVENUE ACT OF 1934 THE PHRASE "TIME OF ACQUISITION" AS USED IN SECTION 113(a)(5) HAD BEEN DEFINED BY LONG-CONTINUED DEPARTMENTAL INTERPRETATION, JUDICIAL DECISIONS AND LEGISLATIVE HISTORY TO MEAN THAT LEGATEES DID NOT ACQUIRE PROPERTY UNTIL A SUBSTANTIAL INTEREST THEREIN BECAME VESTED IN THEM.

In *Van Vranken* v. *Helvering,* 115 F. (2d) 709, 711 (C. C. A. 2nd, December 2, 1940), upon the authority of which the instant cases were decided, the Court below indicated in the following language that it was departing from well-settled canons of statutory construction:

> "At times one is more likely to reach the truth by an unanalyzed and intuitive conclusion from the text as a whole, than by following, step by step, the accredited guides. Therefore, while without Helvering v. Hallock, supra (309 U. S. 106, 60 S. Ct. 444, 84 L. Ed. 604, 125 A. L. R. 1368), we should probably have felt obliged to hold that the statute incorporated the earlier rulings of the lower courts, it appears to us that with that decision before us, we should not preserve what would now be no more than an egregious exception in the fiscal scheme as a whole."

We submit (reversing the sense of the foregoing language) that the Court below was bound to "preserve" the statute as written by Congress in the light of the then

existing rulings and decisions even though the Court six and a half years later reaches the "unanalyzed and intuitive conclusion" that the rule prescribed by Congress is *now* "no more than an egregious exception[1] in the fiscal scheme as a whole." Exception or no exception the rule was prescribed by Congress and should have been "preserved".

We believe that the Court below misunderstood and misapplied the *Hallock* case. Mr. Justice Frankfurter carefully pointed out in the *Hallock* case that the doctrine of Congressional adoption of long-standing administrative construction was not involved. Thus he said at footnote 7, p. 121:

> "Here, unlike the situation in such cases as *National Lead Co.* v. *United States,* 252 U. S. 140, 146-47, and *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, 302-3, we have no conjunction of long, uniform administrative construction and subsequent re-enactments of an ambiguous statute to give ground for implying legislative adoption of such construction. * * *"

Again, in the text at p. 122, this Court said: "Our problem then is not that of rejecting a settled statutory construction."

Judge Dobie, speaking for the majority in *Helvering* v. *Dunning,* 1941 P-H Fed. Tax Serv. § 62,522 (C. C. A. 4th, March 10, 1941), recognized this feature of the *Hallock* case when he said:

> "The Supreme Court had distinctly recognized in the earlier decision of Helvering v. Hallock, supra that the problem therein was 'not that of rejecting

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[1]That it is not an only exception see the discussion of Art. 13, Regulations 80, *infra,* page 35.

> a settled statutory construction.' (309 U. S. at p. 122.) Here, we are dealing with a statutory construction and, as a result, our viewpoint and considerations must at times be technical."

In the instant cases, then, it is of primary importance that when Congress enacted the Revenue Act of 1934 there existed a uniform administrative construction of the language incorporated in § 113(a)(5) of at least fourteen years' standing. Further, at least three courts had uniformly construed this language before the 1934 Act was passed. The Bureau and the Courts had held that *Brewster* v. *Gage* did not apply when the legatee did not have a substantial interest in the property. Under these circumstances Congress must be deemed to have adopted this uniform construction by its reenactment of the language contained in § 113(a)(5), and the Commissioner's Regulations, inconsistent therewith, are invalid. *Helvering* v. *Janney; Taft* v. *Helvering; Helvering* v. *Oregon Mutual Life Insurance Company* (311 U. S. 189, 195 and 267, all decided December 9, 1940).[1]

A. Departmental Interpretation.

Beginning as early as 1920 in interpreting the language which appears in §113(a)(5) of the Revenue Acts of 1934 and 1936, the Bureau of Internal Revenue consistently held until nearly a year after the enactment of the Revenue Act of 1934 that legatees do not acquire property until a substantial interest therein becomes vested in them. O. D. 727, 3 C. B. 53, published in 1920, reads as follows:

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[1]Note that each case struck down an attempt of the Commissioner of Internal Revenue by Regulations 86 involved in the instant cases to change the meaning of various sections of the Revenue Act of 1934.

> "Where in a bequest of property the remaindermen have only a contingent interest prior to the death of the life tenant, the basis for determining gain or loss from a sale of such property by the remaindermen is its value as of the date of death of the life tenant."

Twelve years later in 1932 the General Counsel for the Bureau of Internal Revenue in G. C. M. 10260, XI-1 C. B. 79, 80, said:

> "* * * the position of this office has been that one who has a mere contingent interest does not 'acquire' the property in question until his interest becomes vested. (O. D. 727, C. B. 3, 53; S. M. 4640, C. B. V-1, 60.) (See also I. T. 1622, C. B. II-1, 135; S. O. 35, C. B. 50.)"

That Memorandum cited and distinguished *Brewster* v. *Gage*. See also G. C. M. 11309, XII-1 C. B. 126 (1933). The earlier Memorandum, G. C. M. 6195, VIII-1 C. B. 99 (1929), is not contrary to the long-established Departmental interpretation but is in support of it because the facts set forth in that Memorandum show that the remainderman upon creation of the trust "became substantially the owner of the property".

The Court below, therefore, in holding contrary to the contention of the Petitioners ignored a consistent Departmental interpretation extending from 1920 to 1934 during which period were enacted the Revenue Acts of 1921, 1924, 1926 and 1934 which all contained provisions identical with those involved in these cases.

B. Judicial Interpretation.

In 1930, two years after the enactment of the Revenue Act of 1928, the Supreme Court decided the case of

Brewster v. *Gage*, 280 U. S. 327. That case arose under the Revenue Acts of 1918 and 1921, the latter Act containing a provision identical with that involved in the instant cases. The legatee was left directly, with no intervening estate, a vested interest in the residue of the estate, subject to no contingency or condition. The Court, in holding that the basis of the property acquired by the legatee was determined by its value at the decedent's death, said at p. 334: "Petitioner's right later to have his share of the residue vested immediately upon testator's death. At that time petitioner became enriched by its worth which was directly related to and would increase or decline correspondingly with the value of the property."

It has since been consistently held (at least until within a few months) that the doctrine of *Brewster* v. *Gage* does not cover property acquired pursuant to contingent legacies.

Perhaps the leading case that has established the rule to be applied to contingent interests is the case of *Pringle* v. *Commissioner*, 64 F. (2d) 863 (C. C. A. 9th, 1933), *cert. den.*, 290 U. S. 656 (1933), which was decided well before Congress enacted the Revenue Act of 1934. In that case the facts were similar to those of the instant cases. There the testatrix devised certain real property in trust for a term of years, and at the expiration of the trust to "such of my children as shall be living at the expiration of such trust, share and share alike," with limitations over if any child should then be dead. Testatrix died in 1914, the trust terminated July 25, 1923, and distribution of the property in question was made on July 26, 1923. Petitioners sold the property between July 29, 1923, and August 1 of that year. The question before the Court was what constituted the proper basis for determining income realized

on the sale. This depended upon the meaning of the term "acquisition" as used in the Revenue Act of 1921—the same Act under which the Supreme Court had decided *Brewster* v. *Gage* in 1930. In holding that petitioners "acquired" the property at the date of termination of the trust the Court said at pp. 864-865:

> "It is not questioned that a person cannot be said to have 'acquired' property within the meaning of the Revenue Act, § 202(a)(3), supra, before he has some substantial ownership therein. If his interest is contingent upon the happening of some future event, until the happening of that contingency when his interest becomes vested, he has merely a possibility of acquiring an estate and cannot be said to have any substantial ownership therein. The rulings of the Department of Internal Revenue have consistently been to the effect that where one has merely a contingent interest in property he does not 'acquire' that property until his interest becomes vested. The general counsel of the Treasury Department, in a recent ruling (G. C. M. 10,260, XI-1 C. B. 79, March, 1932), in discussing a question similar to that presented in the case at bar, stated:
>
> "'* * * the position of this office has been that one who has a mere contingent interest does not "acquire" the property in question until his interest becomes vested. (O. D. 727, C. B. 3, 53; S. M. 4640, C. B. V-1, 60.) (See, also, I. T. 1622, C. B. II-1, 135; S. O. 35, C. B. 3, 50.)'
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> * * * * * * * *
>
> "The cases of Brewster v. Gage, 280 U. S. 327, 50 S. Ct. 115, 74 L. Ed. 457, and Chandler v. Field (C. C. A. 1) 63 F. (2d) 13, are not controlling here. In each of those cases the interest of the taxpayer

became vested immediately upon the death of the testator."

Several cases have arisen under § 204(a)(5) of the Revenue Act of 1926, the language of which is practically identical with the language of § 113(a)(5) of the Revenue Acts of 1934 and 1936. In those cases the courts determined that the interests in question were vested and that, therefore, the property was "acquired" on the date of death of the testator. All the cases make it clear, however, that the decisions are based on the fact that the interests before the courts were vested at the testator's death and that different results would have been reached had the interests, as in the instant cases, been contingent.

See *Warner* v. *Commissioner*, 72 F. (2d) 225 (C. C. A. 2d, 1934), *cert. den.*, 293 U. S. 620 (1934), decided under § 204(a)(5) of the Revenue Act of 1926; *Roebling* v. *Commissioner*, 78 F. (2d) 444 (C. C. A. 3d, 1935); *Beers* v. *Commissioner*, 78 F. (2d) 447 (C. C. A. 3d, 1935), *cert. den.*, 296 U. S. 620 (1935); *Hopkins* v. *Commissioner*, 69 F. (2d) 11 (C. C. A. 7th, January 26, 1934), *cert. den.*, 293 U. S. 560 (1934), decided under § 204(a)(5) of the Revenue Acts of 1924 and 1926; and *Molter* v. *Commissioner*, 69 F. (2d) 7 (C. C. A. 7th, 1934).

In at least three cases decided before the enactment of the Revenue Act of 1934 the courts had shown that they did not understand that a legatee "acquired" property before he had a substantial interest therein. *Lane* v. *Corwin*, 63 F. (2d) 767 (C. C. A. 2d, 1933), *cert. den.*, 290 U. S. 644 (1933); *Pringle* v. *Commissioner*, *supra* (1933); and *Anchor Realty & Investment Co.* v. *Becker*, 3 F. Supp. 22 (E. D. Mo. 1933), *aff'd.*, 71 F. (2d) 355. The same rule was recognized in other cases decided before the enactment

of the Revenue Act of 1934, where, however, the remainder was found to be vested. *Chandler* v. *Field,* 63 F. (2d) 13 (C. C. A. 1st, 1933), *cert. den.,* 289 U. S. 758 (1933); *Molter* v. *Commissioner,* 69 F. (2d) 7 (C. C. A. 7th, January 22, 1934); *Hopkins* v. *Commissioner, supra* (January 26, 1934).

The same construction has been uniformly followed through *Reynolds* v. *Commissioner,* 114 F. (2d) 804 (C. C. A. 4th, 1940), by the cases decided after the 1934 Act was enacted. It was even recognized by the Board itself under the 1934 Act as late as November 24, 1939. *Elsie Van Vranken,* 40 B. T. A. 956, petition for certiorari pending before this Court. It was only when the Court below ignored legislative history and all canons of statutory construction in the *Van Vranken* case and reached its "unalyzed and intuitive conclusion" that any court gave recognition to a "value-at-death principle." Prior to that time the courts were satisfied with the plain import of the word "acquired" which is "obtained as one's own." See *Helvering* v. *San Joaquin Co., infra,* pages 32, 33. We are not herein contending that the word "acquired" cannot have the meaning which this Court appears to have given it in the recent *Maguire* and companion cases which arose under the Revenue Acts of 1928 and 1932 but we insist that it did not have that meaning when used by Congress in § 113(a)(5) of the Revenue Acts of 1934 and 1936. It is the then definition of the word that controls the construction of that section.

C. Legislative History.

From the Revenue Act of 1921 through the Revenue Act of 1926, the language of what corresponded to

§ 113(a)(5) of the Revenue Act of 1934 remained unchanged.

In 1926, the Court of Claims, in *McKinney* v. *United States,* 62 Ct. Cl. 180, *cert. den.,* 273 U. S. 716 (1926), decided that, under § 202 of the Revenue Act of 1918, the basis for determining gain or loss on the sale of stock during the period of administration by executors of an estate was the basis of the property in the hands of the decedent and not the value of the property at the decedent's death. In order to change this "inconvenient" rule the Congressional Joint Committee on Internal Revenue Taxation suggested that the rule, whereby the basis was the value of the property at decedent's death, "seems preferable, and it is recommended that it be set forth in the statute." The Report of the House Ways and Means Committee[1] stated at p. 18:

> "In view of the decision of the Court of Claims in McKinney v. United States, it is desirable specifically to provide what basis shall be used in determining gain or loss on the sale of property by an estate. It is believed that the basis should be the value of the property on the date of the decedent's death, and this rule is incorporated in section 113(a)(5).
>
> "It is also provided, in the same paragraph, that the basis in case of a sale by a beneficiary shall be the value of the property on the date of the decedent's death.
>
> "Under existing law, the basis in such a case is the value at the date of 'acquisition', which is indefinite and has given rise to controversy. The value on the date of death affords an equitable and more readily determinable basis."

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[1] 70th Congress, 1st Session, House of Representatives Report No. 2, Union Calendar No. 3.

Accordingly, the House Bill (H. R. 1, 70th Congress, 1st Session) provided in § 113(a)(5) that, "If the property was acquired by bequest, devise, or inheritance, or by a decedent's estate from the decedent, the basis shall be the fair market value of such property *at the time of the death of the decedent.* * * *" [Italics supplied.] By such language the House of Representatives expressed exactly the meaning that the Treasury Department now contends that Congress intended to express in § 113(a)(5) of the Revenue Act of 1934. This provision, however, was not acceptable to the Senate. The Bill, as reported by the Senate Finance Committee, provided in § 113(a)(5) as follows:

> "If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer."

In a detailed discussion of the change made from the House Bill the Report of the Senate Finance Committee reads in part as follows:

> "Accordingly, the committee has revised section 113(a)(5) and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of

> the decedent. *In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death,* and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. *In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer.* The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but, for example, by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary."[1] [Italics supplied.]

The provision recommended by the Senate Committee was adopted by Congress in the Revenue Act of 1928 and was reenacted in the same form in § 113(a)(5) of the Revenue Act of 1932. The effect of the change was a specific recognition that in cases where the beneficiary obtains a substantial interest in the property immediately upon the decedent's death, the proper basis is the value of the property at the date of death; in all other cases (including obviously such contingent bequests as are involved in the instant cases) the basis was to be the value at the time of distribution.

Thus we see that from 1921 to 1928 the statutes contained a provision identical with that which is now before this Court, while from 1928 to 1934 entirely different language was contained in § 113(a)(5). Beginning again

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[1] Senate Report No. 960, 70th Congress, 1st Session, p. 26.

with the 1934 Act, the language of the Acts prior to that of 1928 has been reinstated and continued. In making the change in 1928, however, Congress expressly rejected a wording of the statute which would have made the date of death of the decedent the basic date in all cases. It should also be noted that no specific reference was made at that time, or at any other time, to the problem of contingent interests. The legislative history down to the Revenue Act of 1934 discloses, therefore, a complete absence of any evidence of an intention on the part of Congress to provide that in the case of property acquired by bequest, devise or inheritance the basis in all cases should be the value thereof at the date of death of the decedent. On the contrary, in the only instance in which the question was directly presented to Congress, Congress, after careful consideration evidenced by action by the House and reversal by the Senate and in conference, rejected such provisions.

In 1934 Congress changed from the language used in §113(a)(5) of the Revenue Acts of 1928 and 1932 back to the language used in the Revenue Act of 1926 and prior Acts. In the absence of positive evidence of some other intention on the part of Congress, elementary rules of statutory construction require that the language reenacted in the Revenue Act of 1934 should be construed as was the same language in the Revenue Act of 1926 and prior Revenue Acts.

On December 4, 1933, a subcommittee of the Committee on Ways and Means submitted a Report entitled "Prevention of Tax Avoidance" which in speaking of § 113(a)(5) of the Revenue Act of 1932 made the following comment at p. 17:

> "Included within the phrase 'all other cases' is personal property acquired by general or residuary

bequest. Thus, where a trustee acquires personal property by general bequest, the basis of the property, on a sale by him, is the value at the time of distribution to him. The basis to the executor, in all cases, is the value of the property at the date of the decedent's death.

"Oftentimes, the executor and trustee under a will are one and the same person. Thus, in the case of a general bequest of personal property, he is in a position to make use of one basis of valuation or the other according to which will most benefit the estate. The trustee, of course, may use a later basis than the executor, and where it is desired to sell personal property subject to a trust during the period of administration, the executor-trustee may determine whether it would be most advantageous to sell as executor or as trustee. Where the personal property has increased in value in the hands of the executor, under a general bequest, the property may be distributed to the trustee, who may use the higher basis in computing gain or loss on the sale thereby diminishing the taxable increment and greatly reducing or entirely avoiding the income tax.

"Section 113(a)(5) of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 act. The change in the 1928 act was made because there was some doubt as to the meaning of the term 'date of acquisition,' which was the term used under the Revenue Act of 1926. Since the 1928 act was passed, the Supreme Court has defined 'the date of acquisition' to mean the date of death in the case of all property passing by bequest, devise, and inheritance, whether real or personal. (*Brewster* v. *Gage*, 280 U. S. 327.) Your subcommittee recommends that section 113(a)(5) of the Revenue Act of 1932 be changed to conform to the language contained in the Revenue Act of 1926, so that a

uniform basis rule may be required in the case of property passing at death, whether real or personal."

The proposed change was opposed by the Treasury Department "in accordance with the policy that no change should be made unless it results in a material improvement of the statute."[1] Nevertheless Congress did adopt the proposal to revert to the language of the Revenue Act of 1926 and prior acts the meaning of which had become crystallized through frequent interpretations.

The intention was to revert to the "uniform rule" established under the Revenue Act of 1926 and prior Revenue Acts as interpreted by the courts and the Bureau of Internal Revenue and to get away from the distinctions between real and certain classes of personal property established by the Revenue Act of 1928. The principal motive for reversion to the earlier language appears to have been the desire to prevent an executor of an estate from having a profitable choice of basis when the executor was also the trustee of a trust established by the will of the decedent.[2]

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[1]Statement of the Acting Secretary of the Treasury (p. 16, 1933).

[2]In this connection we advert to the argument of this Court in the *Maguire* case based upon not imputing "to Congress a purpose to allow trustees either to sell the property or to distribute it in kind, as would be most advantageous for tax purposes". This argument is referred to in the Motion to Reverse (p. 4) now pending in *Helvering* v. *Reynolds*, No. 684. We respectfully submit that upon further consideration the argument will be seen to have no validity. Under the doctrine of *Brewster* v. *Gage*, the basis of property in the hands of the trustees is a fixed quantity, viz., value at death. Let us say that is $10. The basis in the hands of the remainderman may be value at death, value at time of distribution to the trustees, or value at time of distribution by the trustees to the remainderman as this Court

In the absence of evidence to the contrary it must be assumed that Congress and its advisors approved of the distinction between vested and contingent interests.

The Reports of the House Ways and Means Committee and the Senate Finance Committee set forth in the Appendix at pp. viii-xi follow the language of the Subcommittee Report and confirm that Congress had only in mind the establishment of a "uniform rule" as between classes of property and had no intention of abolishing the well-established distinction between vested and contingent interests.

D. Cases under the Revenue Acts of 1928 and 1932 do not resolve the questions in the instant cases.

This Court, on March 31, 1941, decided the cases of *Maguire* v. *Commissioner, Helvering* v. *Gambrill* and *Helvering* v. *Campbell,* under § 113(a)(5) of the Revenue Acts of 1928 and 1932. Those cases involved the question of whether a distribution of assets by the executor of an estate to the trustee of a testamentary trust constituted a distribution to a remainderman of the trust. This Court held that such a distribution to the trustee was a distribution to the remainderman. This Court further ruled that, for purposes of determining whether subsequent gains on the sale of assets acquired by bequest were long term or short term capital gains under § 101(c)(8), the property

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may decide. In other words it may be $10, $11, or $12, or it may be $10, $9, or $8. Under the *Maguire* decision it would be either $11 or $9 as compared with the $10 basis of the trustees. In any case, if the will permitted (which it did not in the instant cases), the trustees would have the option to sell the property or to distribute it in kind, as would be most advantageous for tax purposes.

was "held" by the remainderman from the date of death of the decedent.

Different provisions of law and different considerations are involved in the instant cases than were involved in the *Maguire, Gambrill* and *Campbell* cases. In the first place, this Court again pointed out, as in the *Hallock* case, that "We are not aided by administrative construction" because the administrative construction was by no means uniform. And in this respect, there was no helpful administrative construction at all before the enactment of § 113(a)(5) of the Revenue Act of 1928 because there had never before been any comparable provision in the internal revenue laws. In the instant cases, on the other hand, there was a consistent administrative construction of the language reenacted in § 113(a)(5) of the Revenue Act of 1934 originating 14 years earlier.

In the second place, the fixing of the basis as the value at the time of acquisition is not a mere "rule of thumb" but is a matter of substance related to the taxpayer's ownership of the thing the sale of which gave rise to the income. In all the talk about wills, bequests, contingencies, vestings, estates, etc., courts seem to lose touch with the realities of the problem. The problem is simply how much of the selling price of certain definite property sold by the taxpayer shall be treated as income to him. A method obviously fair from the point of view of the taxpayer would be to tax so much of the selling price as is equal to the difference between the value at the time the taxpayer acquired the property and the amount realized by him on the sale. Looked at from that point of view, the date of acquisition is a matter of substance, and Congress has shown in its Committee Reports (*e. g.* the reports in connection with

the Revenue Act of 1928, Appendix, *infra*, pp. vi, vii) that it was sensitive to the question as to when the taxpayer acquired substantial interest in the property in question. In those reports, it is indicated that when, as a matter of substance, the property for all practical purposes vested in the beneficiary immediately upon the decedent's death, the value as of that date should be taken as the basis. In that law, in cases where the property did not vest as of date of death, Congress saw fit to apply a rule which this Court has now characterized as a "rule of thumb", but that action on the part of Congress, however characterized, does not negative the proposition that acquisition of itself is a matter of substance. In the Revenue Act of 1934, Congress abandoned the "rule of thumb" and returned to the substantial test as to when the property was acquired.

In the instant cases, under § 113(a)(5) of the Revenue Acts of 1934 and 1936, the problem is not that of looking back to "a point of reference" to determine gain or loss on property later acquired. There is, of course, no question that at the time of the sales which gave rise to the gain the property had been acquired by the taxpayers, nor is there any question that the acquisition was by bequest. Our problem is to determine the *time* of acquisition. This was not meant by Congress to be a mere "rule of thumb". It was something of substance, directly connected with the taxpayer's ownership of the property sold. At the date of the Testator's death there had certainly been no distribution of the property to the taxpayers in the instant cases.

The Petitioners in the instant cases were twice removed from acquiring any property at the date of death of the Testator. At the date of death the Executors acquired certain property. Later they distributed certain property to

the Trustees. Much later the Trustees distributed the property in question to the Petitioners. It need not even have been the property acquired by the Executors. The will would have been complied with if the Trustees had purchased the required stock. We submit that the decision that the phrase "time of the distribution to the taxpayer" means time of distribution to trustees is not a satisfactory basis for deciding the meaning of the phrase "time of acquisition." We also submit that a decision as to the length of time property was "held" under § 101(c)(8) is also an unsatisfactory basis for deciding the meaning of that phrase.

E. In any event, Regulation 86, promulgated February 11, 1935, cannot affect retroactively tax liability for 1934.

Petitioners contend that the judicial and administrative construction of the word "acquired" was incorporated into § 113(a)(5) of the Revenue Act of 1934 and subsequent Acts and that the attempt on the part of the Commissioner to change that meaning retroactively or prospectively is absolutely void and of no effect whatever. The tax liability of two of the Petitioners, however, involves the year 1934, and as to them, in any event, Regulations 86 cannot retroactively affect their liability for a year prior to the promulgation of the Regulations. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110 (1938).

The Petitioners so situated are Jean Louise Matthews (No. 737, R. 26) and Harry Harkness Flagler (No. 735, R. 28).

For the reasons set forth in this subdivision E as well as for the reasons set forth in subdivision D the instant cases are not decided by the *Maguire* and companion cases.

II.

THE PETITIONERS HEREIN DID NOT ACQUIRE THE PROPERTY SOLD IN 1934 AND 1936 PRIOR TO THE TERMINATION OF THE TRUST CREATED UNDER THE WILL OF HENRY M. FLAGLER.

We do not question that these Petitioners acquired at the date of death of Henry M. Flagler an interest in his Estate. They acquired legacies which were valuable and which doubtless could have been assigned for a substantial consideration. The interest in the Testator's Estate, however, was not the property sold, giving rise to the gain sought to be taxed. Corporate stock was sold and the question is when was that stock acquired. This distinction between the question as posed by the Court below and the question as we believe it to be is indicated in the decision of this Court in the case of *Helvering* v. *San Joaquin Co.*, 297 U. S. 496 (1936). In that case, which we believe to be decisive of the question involved in the instant cases, this Court said at pp. 498-9:

> "The option itself was property, and doubtless was valuable. * * * But the option is admittedly not the same property as the land. * * * But even if we should agree that a lessee-optionee acquires, by virtue of the instrument, an equitable interest in the land it would not follow that, within the contemplation of the revenue acts, he acquires the property at the date of the option rather than at the date of conveyance. The word 'acquired' is not a term of art in the law of property but one in common use. The plain import of the word is 'obtained as one's own.' Language used in tax statutes should be read in the ordinary and natural sense."

As this Court indicated above, there is no magic to the meaning of the word "acquired". It is defined in Webster's New International Dictionary (2d Ed., 1935), p. 23: "To gain by any means * * * to get as one's own * * * ." See also *National Surety Co.* v. *McGreevy,* 64 F. (2d) 899 (C. C. A. 8th, 1933), *cert. den.,* 290 U. S. 644 (1933), wherein the Court said at p. 901: "The word 'acquired,' as used in this contract, means to become the owner of."

This was recognized to be the correct meaning of "acquired" by the Bureau in G. C. M. 10260, XI-1 C. B. 79, 96 (1932). "Contingent beneficiaries or remaindermen are not regarded as having 'acquired' property under the Revenue Acts, and, consequently, in such cases 'distribution,' as well as acquisition, is necessarily contingent until substantial ownership vests, at which time distribution to them is automatically concluded."

We believe, then, that the controlling factor should be substantial ownership. Whenever the taxpayer has *ownership of the property which is later sold* in some substantial degree, and not before, he has acquired that property. If this is the correct rule, as we believe it to be, it is obvious that the description of a legacy as "contingent," "vested" or "vested subject to be divested" is of no primary importance, but it may be of assistance in getting at the ultimate determinant. This was recognized in G. C. M. 10260, *supra,* at page 97, wherein it was said:

> "No one of these things is decisive; the question is whether the taxpayer has acquired sufficiently substantial ownership to satisfy the spirit and purpose of section 113(a)5, and in general, an interest which is vested, subject to being divested, does not give a taxpayer that kind of ownership."

This is merely to apply the well-known statement by Mr. Justice Holmes in *Corliss* v. *Bowers,* 281 U. S. 376, 378 (1930): "But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid."

A situation that could have arisen in the instant cases makes it evident that the only workable rule is that substantial ownership is necessary before property can be acquired. Suppose, for instance, one of the three children of Harry Harkness Flagler had died after the death of the Testator but before the termination of the trust. Then by the express terms of the Testator's will the stock bequeathed to this class would have been divided between the two surviving grandchildren of the Testator. Would the two surviving members of the class have "acquired" their extra one-sixth part of the bequest at the date of the Testator's death? That could only be so if two separate individuals may acquire the same thing at the same time. And if this could be done it is saying, in effect, that each of the Testator's three grandchildren acquired at the Testator's death the whole of what was left to the class. We believe that Congress did not intend to put this interpretation on the word "acquired".

Further, in the above example, let us assume, with the Commissioner, that the stock was acquired by the grandchildren on the death of the Testator. § 811(a) of the Internal Revenue Code provides that the value of the gross estate of a decedent, for estate tax purposes, shall include the value of all property, tangible or intangible, "To the extent of the interest therein of the decedent at the time of his

death." If, then, one of the grandchildren had died after May 20, 1913 and before May 20, 1923, she would, under the Commissioner's theory, have acquired certain stock on May 20, 1913, and we would suppose that the value of that stock would be includible in her gross estate for estate tax purposes. This would be so because the property, if admittedly having been acquired, had never been disposed of prior to death. Therefore it must have been property in which the decedent had an interest at the time of his death. The Commissioner, however, has recognized that this is so obviously not the law that he provides in Regulations 80, Article 13 (as amended by T. D. 5042, March 1, 1941), that nothing need be included in the value of the gross estate on account of a contingent remainder in case the contingency does not happen in the lifetime of the decedent, and the interest consequently lapses at death. This is a recognition that the property which constitutes the subject of a contingent remainder is not acquired until the contingency happens. Also, we might note that apparently the Commissioner does not anticipate too much difficulty in being able to determine what legacies are contingent, and this Treasury Decision was promulgated a year after this Court decided the *Hallock* case.

A reading of the facts in these cases indicates clearly that the Petitioners did not acquire any substantial interest in the property which they sold in 1934 and 1936 prior to the termination of the trust. Moreover, as will now be demonstrated, their interests under the will were contingent and, accordingly, they can not be held to have acquired the property under the narrower but well-established rule that a contingent legatee does not acquire property until his interest vests.

A. Under Florida law Petitioners took only contingent interests under the will.

The question whether a legatee received a vested or a contingent interest under a will must be determined by applying the law of the testator's domicile, particularly if the will was probated in that state. *Uterhart* v. *United States,* 240 U. S. 598 (1916).[1] The State of Florida was the Testator's domicile and the place where the will of the Testator was probated.

The State of Florida has no statute defining the terms "vested" and "contingent", and the question of the category into which the legacies involved in these cases fall must be resolved by applying the common law as interpreted by the Supreme Court of the State of Florida.

There must be a certainty of the right to possession before a remainder can be vested. As expressed by 1 Simes, Law of Future Interests § 67 (1936):

> "In other words, in the vested remainder a right to possession at some time in the future was thought of as having present existence; in the contingent remainder, there was only a condition precedent on the happening of which a right to possession would come into existence."

Although it is often said that the law favors the early vesting of estates, the intention of the testator is a rule of construction in the exposition of wills to which "all others must bend." *Dean* v. *Crews,* 77 Fla. 319, 81 So. 479 (1919).

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[1]See also *Commissioner* v. *Kellog,* 1941 P-H Fed. Tax Serv. § 62,547 (C. C. A. 3d, March 20, 1941).

> "To ascertain and give effect to the intent of the testator is the cardinal rule of testamentary construction. * * * The intention of the testator is to be gathered from a consideration of all the provisions of the will taken together, rather than from detached portions or any particular form of words. This rule prevails whether the entire will or some specific clause or part of it is being construed." *Sorrels* v. *McNally,* 89 Fla. 457, 105 So. 106, 109 (1925).

See also Thompson, Wills § 361 (2d Ed. 1936).

When the intention of the testator as disclosed by the provisions of the will is not clear, the Florida Supreme Court has indulged in various presumptions as an aid in determining what the actual intent was. Thus, one of the strongest arguments in favor of vesting is a provision for the enjoyment of the income by the legatee prior to coming into possession of the property. Also, the absence of a gift over in case the legatee dies before he comes into possession of the property shows that the testator wanted the gifts to be vested. On the other hand, if the income from the principal amount of the gift goes to another than the legatee and if there is a gift over in the event that the legatee does not take because of his death prior to the termination of the preceding estate, the presumption should be that the testator intended to give only a contingent legacy.[1]

1. PETITIONERS IN NOS. 734 AND 737.

The Petitioners, Mary Flagler Cary and Jean Louise Matthews, in Nos. 734 and 737, were two of the three

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[1]Cf. *Sorrels* v. *McNally, supra,* 105 So. 106, 110, 111; *Rowland* v. *Miller, infra,* 88 So. 263, 264.

children of Harry Harkness Flagler and were grandchildren of the Testator. In the only reference in the will of the Testator to the bequest to these Petitioners it was provided as follows:

> "And in the event that at the expiration of said trust there shall be any child or children of my said son living, then I direct that eight thousand shares of the stock of the said Standard Oil Company shall be delivered, assigned and transferred to such child or children as shall then be living, such children, if there be more than one child, to take such stock in equal proportions, and should there be no child of my said son living at the termination of said trust, then such eight thousand shares of stock shall remain a part of such trust estate and go to my wife with the balance of the residue thereof the same as if no provision had been made as to such eight thousand shares of stock."[1]

No possible construction can be placed on the legacies to these Petitioners except that the legacies were contingent, subject to the condition precedent that Petitioners would survive the trust term. The language employed is not that of a present gift to come into possession or enjoyment in the future; the gift itself is future.[2] Further, the income of the trust property was never to go to Petitioners and there was a provision for a gift over if none of Testator's grandchildren was living at the termination of the trust—both strong arguments against vesting.

The above conclusion is fully sustained by the decisions of the Supreme Court of the State of Florida. In *Paul* v. *Frierson,* 21 Fla. 529 (1885), a trust deed provided for

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[1]Item Seventh of last will and testament, R. 25, 26.
[2]Simes, *op. cit. supra,* § 351.

property to go to grantor's wife for life, "and at her death the said property * * * shall be equally divided among such of her children by me begotten as she may leave surviving her. * * *" The question arose as to the inheritability of the interest of a child (Mrs. Paul) who died during the life-time of grantor's wife (Mrs. Frierson). The Court held as follows:

> "The language in the deed in our opinion gave to Mrs. Paul a contingent remainder. There are no words in it which will justify us in construing it as vesting a present fixed right with only the time of actual enjoyment as uncertain. * * *
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> * * * * * * *
>
> "Two things were necessary to determine the right—the death of Mrs. Frierson, and the fact that Mrs. Paul was living at the time of her death. It was uncertain whether the right to the estate would ever vest in Mrs. Paul, and this uncertainty made her interest in it contingent."

The granting clause in the *Paul* case divides the property "at her death * * * among such of her children * * * as she may leave surviving her." Item Seventh of the will of Henry M. Flagler directs the delivery of certain stocks "at the expiration of said trust * * * to such child or children as shall then be living."

In *Rewis* v. *Rewis,* 79 Fla. 126, 84 So. 93, 94 (1920), testatrix devised certain realty to her daughter for life, "and at her death to go to her living children." In a suit to partition, the question arose as to the interest of a child who had died during the continuance of the life estate. The Court held:

> "* * * Having devised the property to her daughter 'to have and to hold during her lifetime,' it was

> not necessary to employ the words 'and at her death' to go to her living children unless it was the intention of the testratrix by such quoted words to fix the meaning of 'her living children' as those living at the death of the life tenant.
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> "The uncertainty as to which of the life tenant's children would survive her made the remainders 'at her death to go to her living children' contingent, and not vested, remainders. * * *"

Here again, the phrase "at her death to go to her living children" is quite similar to the clause in the Flagler will directs the delivery of property "at the expiration of said trust * * * to such child or children as shall then be living."

In *Dean* v. *Crews,* 77 Fla. 319, 81 So. 479, 480 (1919), testator in his will provided that "if when said youngest daughter shall have reached the age of twenty-one years, there shall remain in the hands of the executor of this will more than the sum of three thousand dollars, then the surplus * * * shall be distributed" among four named children. Two of these children died before the youngest daughter reached twenty-one. In deciding that the interests of the deceased children in this bequest were not inheritable, the Court said:

> "The next bequest is clearly to become vested, if at all, when the youngest daughter reaches the age of 21."

The granting clause in this will contains the word "then", as does the clause in the Flagler will which directs the delivery of certain stocks to the children of Harry Harkness Flagler.

In *Blocker* v. *Blocker,* 103 Fla. 285, 137 So. 249 (1931), the testator devised certain property to his son for life,

with remainder to such child or children as survive him, with limitations over if the son should not be survived by a child. The question arose as to whether the children's interest was destructible during the son's life estate. The Court held that, as the children had only contingent remainders, their interest was destructible.

At the time of the final publication of the will of Henry M. Flagler three children of Harry Harkness Flagler were living, including Petitioners in Nos. 734 and 737. The Testator, of course, knew that those three children were in being, yet he made it plain that less than three, and, indeed, none, of those children might take under the will. The members of the class that would take were unascertained until the termination of the trust term. As expressed by Thompson, *op. cit. supra*, § 367:

> "A bequest to one for life, and at her death to be equally divided among her children, creates a contingent remainder in the children, for, until the death of the life tenant [or the expiration of the trust term], it can not be ascertained which of her children will survive her."

The conclusion is inescapable, on authority and reason, and by virtue of the intention of the Testator as expressed in the will, that Petitioners in Nos. 734 and 737 took only contingent legacies.

2. Petitioners in Nos. 735 and 736.

As the stock sold by Annie L. Flagler, whose estate is Petitioner in No. 736, was received as a gift from her husband, Petitioner in No. 735, the time of acquisition of the stock sold by both of these individuals depends upon the

construction of the legacy to Harry Harkness Flagler, Petitioner in No. 735.

The following provisions in the will and codicils are the only expressions directly affecting the legacy to Harry Harkness Flagler:

> "Seventh: At the expiration of said trust, the Trustees shall deliver, assign, and transfer by proper instrument or instruments to my son Harry Harkness Flagler, Five Thousand (5,000) shares of the capital stock of the Standard Oil Company of New Jersey, which shares of stock are hereby given to my said son. * * *"[1]
>
> "I wish further to say, in explanation of the provision made in Item numbered 'Seventh' of my said last will and testament for my son Harry Harkness Flagler, that in case he should not be living at the time of my death or at the time of the expiration of the trust therein referred to * * *, then the legacy of shares of capital stock of the Standard Oil Company therein mentioned shall lapse and become a part of the residue of my estate."[2]
>
> "It is my will that the legacy and bequest to my son, be void and lapse, if my said son should die before me, and in that event, the legacy and bequest, to him, shall become and be part of my residuary estate."[3]

It seems obvious that here also the Testator intended to make a contingent gift which was subject to the condition precedent that the legatee would survive the Testator and also be alive at the termination of the trust. The codicil

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[1]Item Seventh of last will and testament, R. 25, 26.

[2]Item Second of codicil of April 28, 1904, R. 34, 35.

[3]Item Second of codicil of September 13, 1913, R. 45.

of April 28, 1904, contains the condition that in case Harry Harkness Flagler "should not be living at the time of my death or at the time of the expiration of the trust" he should not take anything and the legacy "shall lapse". This provision adds only one condition but in order to be satisfied the legatee must be living at two distinct points of time. Obviously the condition in respect of surviving the Testator is a condition precedent. It would not be possible for the legatee to have any interest whatsoever in the legacy unless he survived the Testator. The same condition of being alive applies also to the termination of the trust. Thus what the Testator intended in connection with the one application of the condition must also apply to the other application of the same condition.

We have pointed out above that the whole will must be read in order to determine the Testator's intent as to any part thereof. An examination of the whole will shows that most of the legacies provided for in the will are contingent. Thus in Item Eighth[1] of the will bequests in various amounts were made to more than 25 named persons and institutions, with the proviso that none shall take "unless * * * living or in existence at the expiration of said trust." The legacies to the children of Harry Harkness Flagler probably throw more light on the Testator's intention in respect to the gift to him, however, than the legacies provided for in Item Eighth. In Item Seventh the Testator directed his Trustees to deliver shares of stock to Harry Harkness Flagler and also to the children of Harry Harkness Flagler. A reading of that whole Item shows that the Testator really intended to treat his son and his grandchildren in the same

[1]R. 26-28.

manner. He there took pains to explain why his son was not put in a preferred status.

Although the Testator undoubtedly intended for the two classes of gifts made in the Seventh Item of his will to be given the same interpretation, he later realized that, because of the loose wording of the gift to his son—the addition of the clause "which shares of stock are hereby given to my said son"—an explanation or clarification of the gift to his son would be necessary. In order to clear up this problem the Testator added a provision in his codicil of April 28, 1904, to the effect that "in case he should not be living at the time of my death or at the time of the expiration of the trust * * * then the legacy of shares of capital stock of the Standard Oil Company therein mentioned shall lapse and become a part of the residue of my estate." This provision effectually eliminated the words of present gift in the original will and left all the legacies provided for in Item Seventh contingent upon the legatees being alive at the expiration of the trust term.

Another reason for concluding that the legacy to Harry Harkness Flagler was contingent is that there was no provision for the enjoyment of the income from the stock by the legatee. By Items Sixth and Ninth of his will the Testator carefully provided that no part of the income of the trust should go to the Petitioners herein and in Item Fifth of the codicil of April 28, 1904, by naming a long list of persons to share in the residuary estate in case his wife should not survive him, he made certain that the Petitioners would not take such income and also made certain that neither the Petitioners nor any persons claiming under them would ever obtain any part of the residuary estate unless the contingencies attached to their bequests were ful-

filled. Indeed, the trustees had a power of invasion as to the principal of the gift, for they were empowered to use some or all of the shares in loans to the Testator's speculative Florida properties.[1] The gift over in the event that the legatee never came into possession of the property is a further indication of the Testator's intention to postpone vesting of the legacy. A reading of the Testator's remarks at the end of Item Seventh of his will and in Item First of the codicil of January 8, 1906, together with the several provisions contained in the will and the various codicils shows beyond any possibility of doubt the firm intention on the part of the Testator to leave nothing to his son or grandchildren unless they satisfied the condition of surviving the term of the trust.

In the case of the legacy to Harry Harkness Flagler as well as in the case of those to his children, authority, as well as reason, supports the conclusion that the legacy was contingent. In *Rowland* v. *Miller,* 81 Fla. 408, 88 So. 263 (1921), testator devised realty as follows:

> "I give and bequeath and devise to my nephew Eugene B. Rowland * * * lot 7 * * * . I desire this property to be held by my executors in trust until the said Eugene B. Rowland shall reach the age of twenty-five years * * * ; if he be not living I desire the property to be sold and the proceeds given to my niece * * * ."

The nephew died before reaching the age of twenty-five years, and the question arose as to the inheritability of his

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[1]Item Tenth of last will and testament, R. 28-30; and Item Third of the codicil of January 8, 1906, R. 38, 39.

interest. The Court held that the entire property belonged to the niece, saying:

> "If Eugene B. Rowland, of Michigan, the nephew, took under that clause any interest whatever in the land described therein, was it conditional or unconditional? Or was the taking of any interest by him made conditional upon his arriving at the age of 25 years? The first sentence of the clause, standing alone, is a complete devise in fee to Eugene B. Rowland of the land described. The second sentence, however, which is divided into two parts, evinces an intention just as clear that a complete devise in fee to Eugene B. Rowland was not intended, because the purpose is expressed to have the property held in trust by his executors, neither of whom was Eugene B. Rowland, of Michigan, until the latter should reach the age of 25 years. * * *
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> * * * * * * * * *
>
> "Here, it seems to have been the testator's purpose that the legal estate should be in his executors. There was something to be done by them which made it necessary for them to have the legal estate. They were to collect rents, pay taxes and insurance, and pay over the residue to his brother, or in case of his death to the niece. Not even the beneficial estate became vested in the nephew."

The Court indicates that the wording of the legacy that is provided for by the clause, "if he be not living I desire the property to be sold and the proceeds" to go over, makes the gift contingent. Thus, the Court poses the question of whether "*any* interest" was taken before the nephew became 25, and the question is answered by saying that "not even

the beneficial estate became vested in the nephew". So it was with Harry Harkness Flagler.

There is a final consideration that proves beyond any doubt that the legacy under discussion in the Flagler will was contingent and not vested. In the codicil of April 28, 1904, it was provided that if the legatee should not be living at the time of the expiration of the trust term then the legacy to him "shall *lapse* and become a part of the residue of my estate." As hereinbefore indicated, the codicil of April 28, 1904, appears to have been drawn with some care to make clear the Testator's intention to make the bequest to his son contingent upon his surviving the trust. We must assume, therefore, that the word "lapse" was used by the draftsman advisedly and that he intended for it to have its usual meaning as a word of art in the law of wills, in order to effectuate the Testator's obvious desire to prefer his widow and others[1] over the personal representatives or appointees of the beneficiaries who failed to survive the trust.

The term has been defined by the Supreme Court of the State of Florida: "A lapsed legacy or devise is one which never vests because of (1) the death of the legatee, before the testator, or (2) if the legatee survive the testator he dies before his interest vests under the will." *Sorrels* v. *McNally,* 89 Fla. 457, 105 So. 106, 109 (1925). This definition is fully supported by other authorities.[2]

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[1]Item Fifth of codicil of April 28, 1904, R. 36.

[2]The word "lapse" refers "to the failure of the devise * * * to take effect." *Gredig* v. *Sterling,* 47 F. (2d) 832, 834 (C. C. A. 5th, 1931), *cert. den.* 284 U. S. 629 (1931). A "lapsed legacy" is one which has never vested or taken effect. *In re Harrington's Will,* 243 App. Div. 235, 276 N. Y. Supp. 868 (4th Dept., 1935); *In re Walter's Estate,* 150 Misc. 512, 516; 269 N. Y. Supp. 402 (N. Y. Co. 1934).

By using the word "lapse" to describe what would happen to the legacy if his son died at any time prior to the termination of the trust the Testator clearly showed his intention to make the legacy contingent upon his son being alive at the time that he was to take possession of the gift. If Harry Harkness Flagler had died during the interim between the Testator's death and the termination of the trust the legacy would have "lapsed", *i.e.*, never have been vested. That the legatee did not in fact die during this period does not change the type of estate that he had[1]—if, indeed, what he had can be dignified by being called an estate of any kind. When the word "lapse" may apply to a legacy there does not exist any kind of estate or property right in the so-called legatee. The estate in the legatee certainly could never vest so long as there was a possibility that the legacy might lapse.

In the only case[2] that your Petitioners have found involving this precise point, the Court of Appeals of New York held that because the testator had provided that the legacy should lapse if the condition attached to the gift was not fulfilled the legacy must necessarily have been contingent. The will in that case provided in part as follows:

> "I give to the Baptist Church * * * the sum of ten thousand dollars * * * towards paying the mortgage and other debts of said church, provided said church shall raise a sum sufficient, with this legacy, to pay off such mortgage and other debts of said church within two years of my decease; and in case

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[1] *Forbes* v. *Commissioner*, 82 F. (2d) 204 (C. C. A. 1st, 1936).

[2] *Booth* v. *Baptist Church*, 126 N. Y. 215 (1891).

of failure to do this, then this legacy shall lapse and go into the residuum of my estate."

This legacy was attacked by the relatives of the Testator on the ground that it unlawfully suspended the power of alienation. This depended upon whether the legacy was vested or contingent. If the latter—the condition being precedent—the legacy must fall.

In holding that the legacy was void the Court at page 242 said:

> "We are asked to say that the legacy vested at the death of the testator, and that the condition imposed was both a condition subsequent and within the power of the legatee to perform through the action of its own members. * * * There are no technical words which indicate the difference between conditions precedent and subsequent, and the question is always one of intention. * * * In the present case it is quite clear that the proviso qualified the vesting of the gift. The testator's purpose was not to give at all unless by the process the church debt could be effectually wiped out. He meant that his proposed legacy should serve as an inducement or stimulant to open the purses of the church members, and to withhold his liberality unless they manifested theirs. He makes it quite clear that there is to be no gift until his condition is fulfilled, for he treats the fund as belonging to his estate and subject to his absolute disposition if the condition is not performed. He provides that in such event the 'legacy shall lapse and go into the residuum' of his estate. A lapsed legacy is one which has never vested or taken effect. It has been defined as 'one which, originally valid, afterwards fails because the capacity or willingness of the donee to take has ceased to exist before he

> obtained a vested interest in the gift.' * * * The provisions for a lapse is the reverse of a forfeiture. The words 'shall go into the residuum' further indicate the testator's understanding that until conditions performed, and within the specified period, he could dispose of the fund as he pleased, and without resort to proceedings for a forfeiture. * * * The gift to the church, therefore, was upon a condition precedent, did not vest at the date of the testator's death, but the ownership was left in abeyance awaiting the result of a contingency, and effected a suspension not measured by lives. We must, therefore, declare it invalid."

Accordingly, it must be concluded that the legacy to Harry Harkness Flagler was contingent and not vested.

B. Petitioners had no substantial ownership of the property until the termination of the trust.

We have shown that Petitioners had no right to receive the property involved in these cases until the termination of the trust in 1923, and the Petitioners had no right to the income from the property during the trust term. We have also shown that Petitioners had no *in rem* interest in the property they received before that time, and, furthermore, the stock to be delivered to the Petitioners at the termination of the trust might have been lost in a speculative railroad and hotel business. Any one of these considerations seems sufficient to show that the Petitioners did not acquire the property involved in these cases at the death of the Testator in 1913. Actually all of these factors were present, and the cumulative effect of all of the limitations on the rights of the Petitioners is stronger than any one

taken separately. When these limitations are given their cumulative effect the conclusion is inescapable that Petitioners had no substantial ownership of the property in question at the Testator's death in 1913. At that time they did have contingent bequests which in themselves may be called property but they did not at that time acquire the property which they sold in 1934 and 1936 and which is involved in these proceedings.

Section 113(a)(5) of the Revenue Acts of 1934 and 1936 as applicable to the instant cases deals with specific property disposed of by the Petitioners in 1934 and 1936 and it is unnatural to assume that when Congress used in that section the terms "acquired" and "time of such acquisition" it intended those terms to be applied to anything but such property. There is not any basis in judicial decisions, departmental interpretation, or legislative history for the assumption that Congress intended to provide that a taxpayer should take as a basis of property disposed of by him the value of similar property at a time when he had only a contingent right[1] to acquire in the future such property.[2]

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[1]In Florida a contingent interest is considered even less substantial than would be true in the vast majority of other American jurisdictions. 1 Simes, *op. cit. supra,* § 113; *cf. Blocker* v. *Blocker,* 103 Fla. 285, *supra.*

[2]Obviously vested and contingent interests are so different that different rules of taxation may be applied in respect thereof. The Supreme Court has upheld the constitutionality of a state statute whereby vested and contingent remainders were taxed differently for inheritance tax purposes. *Salomon* v. *State Tax Commission of New York,* 278 U. S. 484 (1929). There the Court said, page 487: "As the remainders are contingent, it is impossible to know before the contingency happens in whom the remainders will vest * * *." The Court added at page 491: "Moreover, there are differences between vested and contingent remainders which justify classification in imposing inheritance taxes."

CONCLUSION

The decisions of the Circuit Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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APPENDIX

Statutes

Section 202(a) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, provided as follows:

> That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

Section 202(a)(3) of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided in part as follows:

> In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisiton.

Section 204(a)(5) of the Revenue Act of 1924, c. 234, 43 Stat. 253, provided in part as follows:

> If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market value of such property at the time of such acquisition.

Section 204(a)(5) of the Revenue Act of 1926, c. 27, 44 Stat. 9, was the same as Section 204(a)(5) of the Revenue Act of 1924.

Section 113(a)(5) of the Revenue Act of 1928, c. 852, 45 Stat. 791, provided in part as follows:

> **Property Transmitted at Death.**—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer.

Section 113(a)(5) of the Revenue Act of 1932, c. 209, 47 Stat. 169, was the same as Section 113(a)(5) of the Revenue Act of 1928.

Section 113(a)(5) of the Revenue Act of 1934, c. 277, 48 Stat. 680, provided in part as follows:

> **Property Transmitted at Death.**—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition.

Section 113(a)(5) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, was the same as Section 113(a)(5) of the Revenue Act of 1934. The same provision was also included without change as § 113(a)(5) of the Revenue Act of 1938, and § 113(a)(5) of the Internal Revenue Code.

Regulations

Article 113(a)(5)-1 of Regulations 86, under the Revenue Act of 1934, reads in part as follows:

> Art. 113(a)(5)-1. **Basis of property acquired by bequest, devise, or inheritance.**—(a) *Property included.*—Section 113(a)(5) applies—
>
> (1) to all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; and
>
> (2) to property passing under an instrument which, under section 113(a)(5) is treated as though it were a will, but applies to such property only at the times and to the extent prescribed in section 113(a)(5).
>
> (*b*) *Basis.*—Under the law governing wills and the descent and distribution of the property of decedents, all titles to property acquired by bequest, devise or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise. Pursuant to this rule of law, section 113(a)(5) prescribes a single uniform basis rule applicable to all property passing from a decedent by will or under the law governing the descent and distribution of the property of decedents. Accordingly, the time of acquisition of such property is the death of the decedent, and its basis is the fair market value at the time of the decedent's death, regardless of the time when the taxpayer comes into possession and enjoyment of the property. For example, if distribution of personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair

market value at the time when the decedent died, and not when the legatee actually received the property; or, if the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies; or, if the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Act, in prescribing a single uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession of enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other dispositon which section 113(a)(5) recognizes as the measure of gain or loss.

Article 113(a)(5)-1 of Regulations 94, under the Revenue Act of 1936, is the same.

Committee Reports

1928 Act

The Report of the Joint Committee on Internal Revenue Taxation, dated November 15, 1927, contains the following passage (pp. 17-18):

> BASIS FOR GAIN OR LOSS ON SALES BY AN EXECUTOR
>
> Until recently gain or loss on an executor's sale was measured by the value at the decedent's death of what was sold. As a result of the decision by the Court of Claims in *McKinney* v. *United States,* and the denial of certiorari by the United States Supreme Court, the rule was changed so as to provide that gain or loss on such a sale would be measured as though the decedent had sold the property during his life.
>
> The rule of the *McKinney* case is inconvenient, for it is often impossible to determine the decedent's cost or other basis. Moreover, as a practical matter, it results in taxing the value of bequests, devises, and inheritances as income. The old rule seems preferable, and it is recommended that it be set forth in the statute.
>
> Section 204(a)(5) prescribes the basis when the beneficiary sells the property as the value at the time of "acquisition." Some doubt has arisen as to what is meant by the date of acquisition. The "date of death" is recommended to make the basis certain and definite.

The applicable portion of the Report of the House Committee on Ways and Means (House Report No. 2, 70th Congress, 1st Session, p. 18) is set out at page 22 of the Brief.

The Report of the Senate Committee on Finance (Senate Report No. 960, 70th Congress, 1st Session) contains the following passage (p. 26):

SEC. 113.—BASIS FOR DETERMINING GAIN OR LOSS—EXECUTORS' SALE

The decision by the Court of Claims in *McKinney* v. *United States* has caused confusion in the existing law as to the basis on which an executor must determine gain or loss on the sale by him of property of the estate. The House bill in Section 113(a)(5) provides that in such cases the basis shall be the fair market value of the property at the time of the death of the decedent. In the same section the House bill provides the same basis shall be used where the property is sold by the beneficiary.

It appears that the House bill is inadequate to take care of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death cannot properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living.

Accordingly, the committee has revised section 113(a)(5) and certain related sections, so as to provide that in the case of a specific bequest of personality or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. In these cases it may be said, as

a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary.

The Conference Report on the Revenue Act of 1928 (House Report No. 1882, 70th Congress, 1st Session) contains the following passage (p. 14):

> Section 113(a)(5) is amended (No. 75) so as to provide that in the case of specific bequest of personality or a general or specific devise of realty or the transmission of realty by intestacy the basis shall be the fair market value of the property at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The

latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary; and the House recedes * * *.

1934 Act

The applicable portion of the Report of the Subcommittee of the Committee on Ways and Means, dated December 4, 1933, and entitled "Prevention of Tax Avoidance," is set out at pages 25, 26 and 27 of the Brief.

This was followed by a Statement of the Acting Secretary of the Treasury, the relevant portion of which is set out at page 27 of the Brief.

The Report of the Committee on Ways and Means (House Report No. 704, 73rd Congress, 2nd Session, pp. 27-28) contains the following:

> Under Section 113(a)(5) of the Revenue Act of 1932, the basis for determining gain or loss, for income-tax purposes, on the sale or other disposition of property transmitted at death, is, in the following cases, the fair market value thereof at the time of the death of the decedent:
>
> (1) Where personal property was acquired by specific bequest;
>
> (2) Where real property was acquired by general or specific devise, or by intestacy;
>
> (3) Where the property, real or personal, was acquired by the decedent's estate from the deceased.
>
> In all other cases, if the property was acquired by will or intestacy, the basis is the fair market value of the property at the time of distribution to the taxpayer.

Included within the phrase "all other cases" is personal property acquired by general or residuary bequest. Thus, where a trustee acquired personal property by general bequest, the basis of the property on a sale by him, is the value at the time of distribution to him. The basis to the executor, in all cases, is the value of the property at the date of the decedent's death.

Oftentimes, the executor and trustee under a will are one and the same person. Thus, in the case of a general bequest of personal property, he is in a position to make use of one basis of valuation or the other according to which will most benefit the estate. The trustee, of course, may use a later basis than the executor, and where it is desired to sell personal property subject to a trust during the period of administration, the executor-trustee may determine whether it would be most advantageous to sell as executor or as trustee. Where the personal property has increased in value in the hands of the executor, under a general bequest, the property may be distributed to the trustee, who may use the higher basis in computing gain or loss on the sale, thereby diminishing the taxable increment and greatly reducing or entirely avoiding the income tax.

Section 113(a)(5) of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 act. The change in the 1928 act was made because there was some doubt as to the meaning of the term "date of acquisition", which was the term used under the Revenue Act of 1926. Since the 1928 act was passed, the Supreme Court has defined "the date of acquisition" to mean the date of death in the case of all property passing by bequest, devise, and inheritance, whether real or personal. (*Brewster* v. *Gage*, 280 U. S. 327.) Section 113(a)(5) of the bill conforms to the language con-

tained in the Revenue Act of 1926, so that a uniform basis rule may be required in the case of property passing at death, whether real or personal.

The Report of the Senate Committee on Finance (Senate Report No. 558, 73rd Congress, 2nd Session, pp. 34-35) contains the following:

> Under section 113(a)(5) of the Revenue Act of 1932, the basis for determining gain or loss, for income-tax purposes, on the sale or other disposition of property transmitted at death, is, in the following cases, the fair market value thereof at the time of the death of the decedent:
>
> (1) Where personal property was acquired by specific bequest;
>
> (2) Where real property was acquired by general or specific devise, or by intestacy;
>
> (3) Where the property, real or personal, was acquired by the decedent's estate from the deceased.
>
> In all other cases, if the property was acquired by will or intestacy, the basis is the fair market value of the property at the time of distribution to the taxpayer.
>
> Included within the phrase "all other cases" is personal property acquired by general or residuary bequest. Thus, where a trustee acquires personal property by general bequest, the basis of the property on a sale by him, is the value at the time of distribution to him. The basis to the executor, in all cases, is the value of the property at the date of the decedent's death.
>
> Oftentimes, the executor and trustee under a will are one and the same person. Thus, in the case of a general bequest of personal property, he is in a position to make use of one basis of valuation or the other according to which will most benefit the estate. The trustee, of course, may use a later basis than the executor, and where it is desired to sell

personal property subject to a trust during the period of administration, the executor-trustee may determine whether it would be most advantageous to sell as executor or as trustee. Where the personal property has increased in value in the hands of the executor, under a general bequest, the property may be distributed to the trustee, who may use the higher basis in computing gain or loss on the sale, thereby diminishing the taxable increment and greatly reducing or entirely avoiding the income tax.

Section 113(a)(5) of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 act. The change in the 1928 act was made because there was some doubt as to the meaning of the term "date of acquisition", which was the term used under the Revenue Act of 1926. Since the 1928 act was passed, the Supreme Court has defined "the date of acquisition" to mean the date of death in the case of all property passing by bequest, devise, and inheritance, whether real or personal. (*Brewster* v. *Gage*, 280 U. S. 327.) Section 113(a)(5) of the House bill conforms to the language contained in the Revenue Act of 1926, so that a uniform basis rule may be required in the case of property passing at death, whether real or personal. The only change made by your committee to this paragraph of the House bill is to make it clear that if the property of the decedent is sold by the executor or other representative of the estate of the decedent, the basis for computing gain or loss from such sale is the fair market value at the date of death, which is the same basis adopted under the House bill when the property is sold by the beneficiary.